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No. 89-675

IN THE

Supreme Court of the United States

OCTOBER TERM, 1989

AMBASE CORPORATION,

Petitioner,

v.

COMMISSIONER OF INTERNAL REVENUE,

Respondent.

On Petition For A Writ Of Certiorari To The United States Court Of Appeals For The Second Circuit

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REPLY BRIEF

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RULE 29.1 STATEMENT

The Rule 28.1 Statement (now Rule 29.1) made in the Petition for a Writ of Certiorari is still accurate.

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Home[1] seeks review of the court of appeals' judgment disposing of this case on the basis of the Commissioner's authority under section 446(b) of the Code instead of deciding whose construction of section 832 (the Code provision on which Home relies for its method of accounting) was correct. Unable or unwilling to defend the court's unprecedented expansion of his authority under section 446(b) or to refute the

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[1] For convenience, all references throughout the Reply Brief will be to Home rather than to Petitioner.

far-reaching implications of the court's judgment,[2] the Commissioner has chosen instead to oppose certiorari by (1) raising a procedural objection under Rule 10, and (2) asserting a completely new statutory argument under section 832. (Br. Opp. 7-9)[3] These arguments have no merit and should not divert this Court from the importance of reviewing the judgment of the court of appeals.

1. **The Commissioner's Rule 10 Argument.** The Commissioner accuses Home (Br. Opp. 7) of asking this Court to "grant certiorari and remand this case because of a perceived inadequacy in the court of appeals' *opinion*—without considering whether the *judgment* below is correct." To the contrary, Home seeks review of the court of appeals' judgment that the Commissioner's authority under section 446(b) governs the resolution of this case. The fact that Home did not seek review by this Court of the statutory issue under section 832—the issue that was appealed to but not decided by the court of appeals—hardly constitutes a concession (Br. Opp. 6) "of the correctness of the judgment below that the Tax Court

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[2] The most remarkable aspect of the Brief in Opposition is its total absence of any reference to section 446(b), particularly since the Commissioner invited the court of appeals to decide the case under that section. (App. 8a; Comm. Br. 10-11, 35-40) We think it fair to interpret the Commissioner's silence as an acknowledgment that any attempt on his part to defend the court's reliance on section 446(b) would only dramatize further the need for this Court's review.

[3] "Br. Opp." references are to the Brief in Opposition. "Pet." references are to the Petition for a Writ of Certiorari. Other references are as defined in footnotes 2 and 5 of the Petition.

correctly upheld the Commissioner's asserted deficiencies."[4]

Nor is there any merit to the Commissioner's attempt (Br. Opp. 6-7) to analogize the court of appeals' judgment in this case to a simple affirmance of a lower court's decision. Unlike the court of appeals, the Tax Court did not rely on section 446(b) to dispose of this case; the Tax Court decided (albeit in Home's view incorrectly) the statutory issue presented to it under section 832.[5] By stating (App. 3a) that it affirmed the Tax Court "[f]or the reasons which follow", the court of appeals made it clear that its judgment was based on its own rationale, not the Tax Court's rationale. Thus, the Commissioner's portrayal (Br. Opp. 7) of Home as suggesting "that every affirmance without opinion by a court of appeals automatically would call for Supreme Court review" is totally unfounded.

2. **The Commissioner's Statutory Grounds for Opposing Certiorari**. The Commissioner's decision neither to defend the court of appeals' reliance on section 446(b) nor to dispute the importance of reviewing the issues raised in the Petition stands in sharp contrast to his willingness to raise a new argument under section 832. Presumably, he would have

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[4] The fact that Home does not seek review by this Court of the statutory issue arising under section 832 of the Code does not lessen the importance of reviewing the separate issues involving the court of appeals' unprecedented expansion of the Commissioner's authority under section 446(b).

[5] While the Tax Court considered "clear reflection of income" principles, it did so *only* in connection with its holding under the more specific and directly applicable provisions of section 832. (App. 22a-25a)

this Court believe that the ultimate result in this case would be the same even if the case were decided under section 832. Thus, he asserts: (a) the court of appeals' decision "accords with" *Western Casualty & Surety Co. v. Commissioner*, 571 F.2d 514 (10th Cir. 1978) (Br. Opp. 6); (b) the court of appeals "agrees with" *Gerling Int'l Ins. Co. v. Commissioner*, 839 F.2d 131 (3d Cir. 1988) (Br. Opp. 9 n.4); (c) there is no merit to Home's argument that section 832(b)(6) is rendered a "dead letter" (Br. Opp. 7-9); and (d) the opinion below conforms to the section 832(b)(6) analysis contained in the Brief in Opposition. (Br. Opp. 9 n.4) These assertions are neither correct nor a basis for denying certiorari.

a. The decision below does not accord with *Western Casualty*, because (i) that case was decided under the provisions of section 832, not section 446(b), (ii) the arguments made by the taxpayer in *Western Casualty* differed in several crucial respects from those made by Home below (Br. 39-41; Pet. 12 n.11), and (iii) the courts in *Western Casualty* did not, of course, have an opportunity to consider the implications of the 1986 legislative amendment of section 832(b)(4).

b. *Gerling* is irrelevant because it dealt with a completely different issue (*viz.*, the imposition of sanctions for failing to produce documents and information). Consequently, while the footnote in *Gerling* cited by the Commissioner contains an accurate summary of the holding in *Western Casualty*, the court in *Gerling* did not consider whether *Western Casualty* was correctly decided.

c. The Commissioner attempts here for the first time to respond to Home's "dead letter" argument. (Br. Opp. 8-9) He now says that the definition of

"expenses incurred" in section 832(b)(6) is relevant only with respect to expenses that are attributable to items of income that are included in gross income. Since the commission expenses at issue in this case relate to unearned premiums that are not included in gross income under section 832(b)(3), the Commissioner says that the commission expenses may not be treated as "expenses incurred" under section 832(b)(6).

The Commissioner's new argument is patently wrong and flies in the face of section 832(b)(6), which defines "expenses incurred" to mean "*all* expenses shown on the annual statement approved by the National Association of Insurance Commissioners." (Emphasis added.) As the Commissioner acknowledged below, it is irrelevant under section 832(b)(6) whether expenses shown on the annual statement relate to unearned premiums.[6] In addition to other problems, the argument also conflicts with the 1986 amendment to section 832(b)(4), which requires that 20 percent

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[6] The argument contained in the Brief in Opposition is not only new but is also inconsistent with the Commissioner's statutory argument in the courts below. The Commissioner relied below on the last sentence of section 832(b)(6), which provides, in part, that—

> there shall be deducted from expenses incurred (as defined in this paragraph) all expenses incurred which are not allowed as deductions by subsection (c).

The Commissioner argued successfully in the Tax Court that, by virtue of the cross-reference in the last sentence of section 832(b)(6) to section 832(c) and the further cross-reference in section 832(c)(1) to section 162, the commissions were required to satisfy the "all events" test applicable to accrual basis taxpayers. (App. 7a, 19a, 23a-24a; Comm. Br. 9-29)

of unearned premiums be included in gross income precisely because items relating to unearned premiums are included in "expenses incurred." (Br. 25-28) Furthermore, the Commissioner's new argument makes section 832(b)(6) no less a dead letter than did his former statutory argument, because even under his new argument the tax liability of a property and casualty insurance company would not be changed by one cent if section 832(b)(6) were repealed.

d. Nor, since this new argument was not considered by the court of appeals, can there be any merit to the Commissioner's assertion (Br. Opp. 9 n.4) that "[t]he opinion of the court of appeals conforms to this analysis."[7]

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[7] At least the Commissioner acknowledges (Br. Opp. 9 n.4) that "the opinion does not in so many words state why Section 832(b)(6) is not a 'dead letter.' " He appears, however, to imply (Br. Opp. 8, 9 n.4) that the court of appeals' judgment was, in fact, based on the relevant provisions of section 832, as well as section 446(b). That interpretation does not withstand scrutiny of the court's opinion. The opinion merely repeats the relevant provisions of section 832 and summarizes the Tax Court's holding, Home's arguments, and the Commissioner's arguments (App. 6a-8a), but does not purport to decide the statutory issue under section 832(b)(6). Instead, the court concludes (App. 11a) that "[i]n view of the ambiguity of the Code provisions in question, we cannot say that the Commissioner's disallowance of Home's deductions was 'clearly unlawful' [within the meaning of the cases construing the Commissioner's authority under section 446(b)]." (Footnote omitted.) There is not *one* word of reasoned analysis in the court of appeals' opinion as to why, *under the provisions of section 832*, the Commissioner should prevail. Furthermore, had the court adopted the Commissioner's construction of section 832, there would have been no need for the court to resort to section 446(b). In short, the court of appeals turned this case into a section 446(b) case, there is no other way to read the court's opinion.

In addition, Home respectfully suggests that it would be a miscarriage of justice to deny certiorari on the basis of the Commissioner's new argument. Home's fundamental objection to the judgment below is that the court of appeals did not decide the case under the governing statutory provision. Home's conviction that its statutory analysis under section 832 is correct was reinforced by the Commissioner's prior unwillingness to respond to Home's "dead letter" argument and the court of appeals' unprecedented reliance on section 446(b) to avoid deciding the statutory issue. Home's conviction is further reinforced by the Commissioner's decision to advance a completely new argument at this late stage. Accordingly, it would be particularly unfair if Home were denied the judicial determination to which it believes it is entitled because of an argument (which Home is convinced is completely meritless) advanced for the first time in opposition to Home's petition for certiorari.

Finally, even if the new argument had any merit, that would not diminish the importance of granting certiorari to review the judgment actually rendered by the court of appeals under section 446(b). That judgment would still stand even if the same result could have been reached under a different Code section.

CONCLUSION

The petition for a writ of certiorari to review the judgment of the United States Court of Appeals for the Second Circuit in this case should be granted.

In view of the Commissioner's failure to defend the court of appeals' reliance on section 446(b), it may be appropriate for this Court to reverse summarily

the judgment below and to remand the case to the court of appeals for a determination of the statutory issue under section 832 previously presented to it on appeal. Alternatively, plenary consideration should be given to the issues raised in the Petition.

Respectfully submitted,

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